No. 82-1258

In the
Supreme Court of the United States

BRAEMOOR ASSOCIATES, a joint venture, and LAMBERT BERE, JR., OWEN HULSE, JR., CHARLES M. BENNETT, GEORGE JOUSMA, and WILLIAM J. KAYE, individually and as joint ventures doing business as Braemoor Associates,

Petitioners,

vs.

FEDERAL DEPOSIT INSURANCE CORPORATION,

Respondent.

PETITIONER'S REPLY TO BRIEF FOR RESPONDENT IN OPPOSITION

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ARGUMENT

The Federal Deposit Insurance Corporation ("FDIC") in its brief in opposition mischaracterizes the attack of the Petitioners as well as mischaracterizes the evidence and the district court fact finding. The court of appeals set aside fact findings of the district court Judge without finding them clearly erroneous in derogation of Rule 52 of the Federal Rules of Civil Procedure and decided the appeal on law not argued in the district court. Further, the separate question remains as to the conflict of circuits as to the circumstances when a theory of law may be presented to the Court of Appeals when it was not argued below.

The FDIC on page 7 of its brief cites several cases it relied on *in the Seventh Circuit* and in a footnote on that page states that these cases had been raised in the district court. However, these cases were ***not*** cited by

the FDIC in any district court pleadings that are a part of the record on appeal. The FDIC maintains that these cases placed before the court are authority for the fiduciary duties of Paul Bere and are a basis of liability in this case. The liability that the FDIC seeks to impose on defendants in this case is *per se* liability due to Paul Bere's acts with regard to two loans. However, the Seventh Circuit clearly states that "it is not unlawful per se for an Illinois Bank to make a loan to its officers, or to enterprises which the officers control or actively manage". (Pet. App. p. 38). It is only due to the Section 37(1) of the Illinois Banking Act, Ill. Rev. Stat. 1981, Ch. 17, § 347(1) that such loans if they exceed $10,000 must be brought before the bank's board of directors, Thus, if there was an impropriety by Paul Bere as to the loans at issue, that impropriety was not due to case law, it is rather due only to the provision of the Illinois Banking Act, and the FDIC failed to ever mention that act orally or by pleading in the district court, failed to ever mention that act in its court of appeals briefs or in oral argument to the court of appeals, and did not even rely on that act in response to defendant's petition for rehearing in the court of appeals. That foundation block upon which the court of appeal's decision is based was not placed before the district court and was not placed before the court of appeals by any party as authoirty for a decision.

In fact the FDIC did not even rely on the partnership statutes it cites in its brief in opposition in its presentations to the district court on brief after the conclusion of its case. The FDIC lightly and in a general sense mentioned some partnership law in its pretrial order and in it *pretrial* submission of proposed findings of fact and conclusions of law. But partnership law was not the

basis of the FDIC's contentions of defendant's liability in its brief after the conclusion of its case. The FDIC chose to rely on other principles. The FDIC brief after the conclusion of its case is divided into four parts. The first part states background facts. Another part argues the conspiracy theory that was rejected both by the district court and by the court of appeals. A third part argues liability based on a theory of defendants' liability based on Paul Bere's "express or implied authority" from defendants. At paragraphs 67 and 68 of the district court's findings (Pet. App. 16) the district court found that there was no such express or implied authority, and that finding is not stated to be clearly erroneous by the Seventh Circuit. The last theory argued by the FDIC after the trial was a theory of "constructive knowledge" based on the theory that defendants are charged with constructive knowledge and are liable as constructive trustees because they knew that Paul Bere was a fiduciary of the bank and knew that every circumstance relating to their transactions with Paul and the bank was "so extraordinary" that they were under a duty to investigate and were liable for failure to investigate because such investigation would have made them knowledgable as to Paul's breach. The FDIC's constructive trustee argument in the FDIC district court brief is attached hereto so that this Court can see the limited extent of the FDIC argument to the district court. And the district court responded to that argument, as it responded to the other arguments that the FDIC made to it. At paragraph 66 of its findings of fact (Pet. App. 16) the district court judge found that "The circumstances of the financial transactions between defendants and Paul were *not* so extraordinary that the defendants should

have known of Paul's breach of trust nor were the defendants in possession of such facts sufficient to alert a reasonable person to inquire whether Paul was breaching his trust".

The FDIC on page 8 of its brief in opposition is critical of the district court judge for making no findings whatsoever on the question whether petitioners could be charged under general principles of partnership law with imputed knowledge of wrongful acts. While briefly mentioning partnership law in pretrial submissions including a *pretrial* submission of proposed findings of fact and conclusions of law, the FDIC chose to rely only on three *other* theories of liability after is closed its case and the district court squarely responded to those three theories in the opinion. The district court judge was not required to go beyond what was finally relied upon by the parties. He is not required to search for other theories in the adversary proceeding. The trial court, having no opportunity of passing upon the issue now relied on, cannot be charged with error in failing to do what it was not requested to do. *Gilby* v. *Travelers Ins. Co.*, 248 F. 2d 794 at 797 (8th Cir., 1957).

Separately, the court of appeals usurped the fact finding function of the district court in changing the facts found by the district court without finding them clearly erroneous and with no basis making them support the new partnership theories raised in the court of appeals. Though the issue of the two sections of partnership law relied on by the FDIC was not finally relied on by the FDIC in the district court, the district court's findings of fact preclude the application of either section to this case.

Regarding section 13 of the Uniform Partnership Act (Ill. Rev. Stat. ch. 106½), that section by its terms does not apply unless the partner involved either is (1) acting in the ordinary course of business of the partnership or (2) with the authority of his copartners. Ringbloom was purchasing two parcels of real estate from Braemoor with the money involved in the two loans at issue. (Tr. 147-149, 106-107, 156-157). The district court in dealing with all transactions in the case, at findings of fact, paragraph 69, held that the loan transaction at issue was made to aid Rightbloom in the purchase of that property rather than as a device for the purpose of financing (or laundering money for) the Braemoor partnership (Pet. App. 16). Thus, the district court found that the loan transactions did not have as their purpose doing something for the business of Braemoor and thus clearly the element of Paul's act being in the ordinary course of Braemoor's business is absent. Secondly, the District Court found at paragraphs 67 and 68 of its findings (Pet. App. 16) that Paul Bere was not so acting with express or implied authority of his copartners. Thus, section 13 of the Uniform Partnership Act cannot be applied to create liability as to defendants.

Similarly, Section 12 of the Uniform Partnership Act (Ill. Rev. Stat. ch. 106½) also cannot be so applied. By its terms the matter involved must relate to partnership affairs before that section is applicable. As just stated, the district court found that the loan was for Ringbloom to purchase property and not to finance or launder money to Braemoor. Therefore, what is involved is not a matter relating to Braemoor partnership affairs and Section 12 cannot be applied to create liability as to Braemoor and its other partners. In addition, an ex-

ception to Section 12 exists where the partner involved in the action is committing fraud on the partnership. In the $240,000 loan transaction, Paul Bere who arranged the loan was a 50% partner of the borrower who was purchasing from Braemoor and that fact was unknown to the defendants so that Paul Bere was using the loan transaction to secretly gain a 50% interest in the land in which he had previously had a 16⅔% interest. (Pl. Ex. 1, tr. 147, 153). Paul arranged the sale from Braemoor so he could secretly be a purchaser and that is not only acting outside the Braemoor partnership affairs, that is committing fraud on Braemoor. Thus, we have two reasons based on the clear language of Section 12 of the Uniform Partnership Act as to why that section does not apply to this case and each reason is independent of the other. Further, *Rowely Law of Partnership*, 2nd Ed., Volume 1, section 12.2 supports what is stated here.

Though the court of appeals opinion does not hold that the district court findings of facts which negate the application of the Uniform Partnership Act were clearly erroneous, it will be shown that those findings of fact were clearly based on the evidence and that evidence is in fact not as characterized by the FDIC in its brief in opposition.

The District Court found defendants' testimony to be credible at finding of fact paragraph 62 (Pet. App. 15). Defendants testified that Paul's action on the loans was not within his authority and the district court so found. (Tr. 269-270, 290, 314-315). Further, the district court found at paragraph 71 of its findings of fact that at the time of the transactions at issue, the defendants, both

in their individual capacities and as a partnership, had sufficient sources of credit other than the State Bank of Clearing to meet their obligations as they became due (Pet. App. 16). Petitioners were thus not under the pressure to get the money from the State Bank of Clearing as implied in the FDIC brief in opposition. In fact, Petitioners were not under pressure in either of the two transactions that were paid with proceeds from the two land sales to Ringbloom. Regarding the $60,000 payment on the water tower, though that payment was due, there was a 15-day cure section in the contract after written notice of default, there was no written notice of default; if such a notice was received petitioners had a $700.000-$800,000 line of credit at the Chicago City Bank where at the time they had paid a $500,000 loan down to $325,000 and they could easily have obtained money for the $60,000 payment if they needed it, and further, the person due that money did not consider the contract in default, but rather wrote, as is stipulated, that "the entire sale and conclusion of the transaction was handled in a first class business-like manner, with no troubles or problems encountered along the way" (Stipulation par. 21.4, Tr. 135, 136, 145, 134, 187). As to the $240,000 transaction, the company which was owed the money was owed $440,000 and had not demanded payment of that sum, but was instead financing Braemoor. (Tr. 133, 134, 144, 262). Again as stated above, had petitioners needed the money, they had the sources to get it from which were other than Paul Bere's bank. It also must be noted that the FDIC claims that Ringbloom could not have made the payment without the $240,000. However, the stipulation does not show cash problems for the Ringbloom company involved.

Paragraph 39.2 of the stipulation of facts of the parties shows that from the date Ringbloom's company wrote the $240,000 check to the date that check cleared that company's account, over $800,000 cleared that account.

What Paul Bere did was clearly for Ringbloom. The $60,000 and the $240,000 helped Ringbloom to acquire property for development. Ringbloom was a favored customer of the bank where he and his entities were permitted regularly to have overdrafts in their checking accounts of tens of thousands of dollars and were given loans which exceeded four and a half million dollars when the bank's lending limit was about $500,000. (Stipulation par. 3.5.2, 3.6, 3.7 and schedules A, B, and C thereto, tr. 42). Ringbloom's success with acquiring such property should have aided his paying back that indebtedness which was in Paul's interest. Further, as stated, the $240,000 loan enabled not only Ringbloom to acquire the property, but enabled Paul Bere to secretly obtain a 50% ownership in the acquired property. Thus, the breaches by Paul were for Ringbloom's benefit and for Paul's own benefit and Braemoor's property sale was a means to that benefit. All of this solidly supports the district court's finding that the loans were not designed for petitioners Braemoor's benefit. The loans were not to launder money for Braemoor.

It is also noted, though it is merely a bonus for Petitioner's lack of liability, that the stipulation shows the $240,000 taken on Paul's filling out of Lambert's blank note was, as is stipulated, repaid to the bank within 21 days by loans taken out by Albany Supply Co., Ringbloom Construction Co., and possibly by Indian Trails Apartments and the $60,000 was repaid to the bank in

the $400,000 loan to Ringbloom from the Marquette Bank which was repaid by $335,000 and portions of a $465,000 loan to Ringbloom and Western Construction Company. (Stip. par. 29.2, 29.41, 41.1, 41.2, 41.3, 42, 42.1). There is absolutely no evidence that petitioners were involved in those transactions and they were not so involved (Entire Record).

The FDIC states in its brief in opposition that the court of appeals carefully decided and correctly decided the issues presented. It should be obvious that this is incorrect. The entire first opinion of the court of appeals was based on the assumption that the board of directors of the bank had not approved the loans in question whereas paragraph 55 of the stipulation of the parties clearly stated otherwise. That is but one instance of the court of appeals ignoring the record and tailoring the facts to the desired opinion and the amended opinion continued that disregard of the record and of the function of the district court judge. The assertion by the court of appeals that petitioners were under pressure to pay creditors and that the loans were really methods of laundering money to get it to petitioners to pay the debts is contrary to the record and to the findings of the district court and is done without any finding or possibility of a finding that the district court findings were clearly erroneous as required by Rule 52 of the Federal Rules of Civil Procedure. And the District Court findings were based on the totality of the transactions. The district court knew the money eventually went to Braemoor in exchange for property, but held that the purpose of the transaction was not to finance Braemoor, but was to finance Ringbloom. The supervisory power of the United States Supreme Court is properly invoked because "It is

not enough that we (the Supreme Court or an appellate court) might give the facts another construction, resolve the ambiguities differently, and find a more sinister cast to actions which the district court deemed innocent. We are not given those choices because our mandate is not to set aside findings of fact 'unless clearly erroneous'". *United States* v. *Real Estate Board,* 339 U.S. 485 at 495-6.

CONCLUSION

The exercise of the supervisory power of this Court is most important for the integrity of the court system and it is also important at this time when this Court is asking Congress for aid as to congestion. That supervision should reduce writs to this Court and will send a message that the courts of appeal are not the place for de novo litigating and will protect and encourage the conscientious exercise of the trial function by the district court judges as well as do justice in this case. For reasons stated herein and in the Petition, the writ of certiorari should be granted.

Respectfully submitted,

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REPLY BRIEF APPENDIX

PORTION OF FDIC DISTRICT COURT BRIEF

III. DEFENDANTS' CONSTRUCTIVE KNOWLEDGE

Even if it is assumed arguendo that Paul had neither express nor implied authority to obtain the two loans in question on behalf of the venture, the defendants are nonetheless liable on the ground that they had constructive knowledge of Paul's breach of his fiduciary duties to the bank and the use of those loan proceeds for the benefit of Braemoor Associates. Plaintiff's Pre-Trial Brief cites a number of cases (on pages 8-19) which support plaintiff's claim that the defendants are charged with constructive knowledge and are liable as constructive trustees. Without repeating all that was said there, we want to call attention in particular to the case of *Higgins* v. *Shenango Pottery Company*, 256 F.2d 504, 510 (3rd Cir. 1958), which is discussed on pages 13-14 of our Pre-Trial Brief.

In the *Higgins* case, a partnership was composed of certain corporate officers and the three defendants who were not employees of the corporation. The officer-partners diverted corporate business to the partnership. In holding the three non-employee defendants liable as constructive trustees, the Court used language which is applicable to the defendants in this case:

> "There is enough in the proofs from which it may be inferred that they knew or should have known that the Castle scheme [the partnership business] was contrary to the best interests of Shenango [the corporation]; that *every circumstance relating to the transaction was so extraordinary* that these men, partners in Castle, could not stand by and avoid even a simple inquiry; that dealing as they were with these Shenango fiduciaries, knowing who they were and therefore, what they were, Pfau, McCarty

> and Shumaker were bound to *ascertain whether their partners were violating their trust*; that because they were chargeable with knowledge of the breach, or at least with the compelling duty of inquiry, they must make restitution for the benefits they have realized as a consequence of the breach of trust." (256 F.2d at 510, Emphasis added)

Similarly, the Braemoor defendants knew that Paul was a fiduciary of the Bank and knew that "every circumstance" relating to their transactions with Paul and the Bank was "so extraordinary" that they were under a duty to investigate. A diligent inquiry would have disclosed Paul's breach and the use of the loan proceeds for the defendants' benefit.

The extraordinary circumstances known to the defendants included their knowledge of Paul's conduct in arranging the 19 loans discussed at pages 9-12, supra, all of which Paul had caused the Bank to make nominally to the individual partners for the real benefit of Braemoor or some other venture in which Paul and the defendants were personally interested. The defendants were well aware of Paul's fiduciary relationship to the Bank, his conflict of interest and his personal benefit from all of the loans which were made to the defendants. The defendants cooperated with Paul in an on-going scheme to conceal from the bank Paul's secret interest, his breaches of trust, and the identity of the true beneficiaries of the loans.

In addition, the defendants knew that Ringbloom was a contractor; and at least some of the defendants were aware that Ringbloom was a customer of the Bank and assumed that he borrowed from the bank, although they did not know the specific amount of any loans. (Tr. 104, 113, 250-1, 286, 304) The defendants also knew, or certainly should have known, that Paul would have a conflict of interest and would violate his fiduciary duties to the Bank if he caused the bank to finance Braemoor's sale of its land whether to Ringbloom or to anyone else.

The defendants' knowledge of all the foregoing facts was itself sufficient to put the defendants on inquiry to determine whether Paul had financed Ringbloom's purchase of Braemoor property by making loans from the State Bank of Clearing. Over and beyond such general knowledge, however, Lambert and Bennett knew the extraordinary circumstances surrounding the $417,567.71 loan transaction in July 1972.

Lambert received a personal checking account statement from the State Bank of Clearing in early August 1972 showing an unexpected credit of $417,567.71 and two offsetting debits of $167,567.71 and $250,000. (Stip. ¶¶38-38.3 and PX 35) Lambert asked Paul for an explanation, but never got a satisfactory answer, or an answer he could understand. (Tr. 203-204) According to Lambert, he was only told the obvious — that the money went in and out. (Tr. 204) The defendants erroneously claim in paragraph 13 on page 10 of their Post-Trial Suggested Findings of Fact that Lambert ". . . asked his brother Paul Bere for an explanation and got none and had thought it was a clerical error (Tr. 219-220, 222)." This is not entirely correct. Reference to the cited pages and also pages 203, 206 and 236 of the Transcript shows that Lambert's "first reaction" was to think the entries were a clerical error *before* he talked with Paul. (Tr. 203) After talking with Paul, Lambert knew that there was no clerical error and knew that Paul was responsible for the entries having been made. (Tr. 206, 236)

Lambert claims he did not receive any debit memos to support the two debits on his bank statement (Tr. 204), but there was other evidence that he must have received them. The testimony of Howard Wagner, admitted by stipulation, was that debit memos were always prepared in duplicate and one copy would be immediately mailed to the customer. The second copy was sent to the Continental Bank, which prepared the monthly checking account statements for State Bank of Clearing cus-

tomers. The Continental Bank had to have a check or debit memo in order to post any debit on the statement. (Tr. 323-4) Howard Wagner also testified that at the end of each month the Continental Bank sent the statements to the State Bank of Clearing where employees under his direct supervision verified that each debit on a customer's statement was supported by a check or debit memo and then mailed the statement, checks and the duplicate debit memos to the customer. (Tr. 323-324) Lambert himself admitted that the bank's practice was to mail one copy of the debit memo to the customer and enclose the other copy in the statement. (Tr. 204-205) There is, accordingly, highly credible evidence that Lambert *did* receive the debit memos which clearly stated that the two debits were not to correct any clerical errors but were to pay off certain Ringbloom loans and to transfer $250,000 in cash to Western. (PX 36)

Even if it is assumed that Lambert did not get either copy of the two debit memos, he knew that he should have received the debit memos in the mail and duplicate copies with his statement. (Tr. 204-5) He knew they existed and that he could easily obtain them from the Bank if he asked. (Tr. 207) The large dollar amount of the entries, the missing debit memos and Paul's evasive response by themselves should have prompted further inquiry by Lambert. Moreover, after looking at his bank statement (PX 35) and talking with Paul in early August 1972, Lambert knew that $250,000 had been transferred from his account to someone on July 17, 1972, and he also knew that Braemoor had received $240,000 from Western around July 25, 1972. (Tr. 122-3, 185, 201) The simplest inquiry by Lambert at the bank would have revealed that Paul had filled in the note which Lambert had signed in blank a few months earlier, that Paul had used that note to obtain a $417,567 loan from the bank, that Paul had transferred $250,000 of the loan proceeds to Western, and that Western had used $240,000 of those funds to pay Braemoor. Lambert would thus

have quickly and easily discovered the relationship between the entries on his bank statement and the payment to Braemoor, if he didn't already suspect such a relationship existed because of the past pattern of indirect financing by Paul. There is no excuse for Lambert's failure to make the very obvious, simple and easy inquiry which would have revealed the facts concerning the transaction.

Lambert attempted to excuse his failure to inquire at the bank about the $417,567.71 credit and the two debits by saying that he considered it to be "a private matter". (Tr. 207) But Lambert undercut his own explanation when he admitted that he mentioned the matter to Bennett and told Bennett that he was "shocked by the entry". (Tr. 238) Lambert then decided that he told Bennett that the money had been withdrawn from his account by two debit memos. (Tr. 239) Bennett, however, recalled that Lambert claimed he did not have the debit memos (Tr. 266), a statement which indicates that Lambert and Bennett must have discussed the entries on his bank statement in some detail. Perhaps realizing the contradiction between his excuse of privacy and his discussion with Bennett, Lambert tried to characterize his comments to Bennett as "a joking remark" and made "in a joking way". (Tr. 239) Bennett, however, did not characterize Lambert's comments as a joke, but rather recalled that Lambert "was really wondering what it was all about". (Tr. 265) Lambert's attitude was not that of someone who was trying to make a joke out of a mysterious $417,000.

When Paul refused to give an understandable explanation of where the $250,000 had gone, Lambert realized that he was not supposed to ask questions and deliberately chose not to ask for copies of the debit memos (which he knew existed and which were available on microfilm, as evidenced by PX 36). Under the circumstances, Lambert's minimal inquiry of Paul did not satisfy his duty of diligent inquiry; Paul's evasive response

itself should have prompted further inquiry by Lambert. Lambert's decision not to inquire was not prompted by any alleged feelings of "privacy", but rather by a desire to avoid having others at the Bank discover Paul's interest in Braemoor Associates, the history of his breaches of trust, the complicity of the Braemoor partners in those breaches and the fact that Braemoor had been the real beneficiary of the two loan transactions.

In view of all the extraordinary circumstances as set forth above and the law set forth in the *Higgins* case, supra, and other cases cited in plaintiff's Pre-Trial Brief, we submit that the defendants are charged with constructive knowledge of Paul's breach of fiduciary duties and are liable as constructive trustees for the full $300,000.